

Houston - Second Workshop

CRUDE OIL VALUATION WORKSHOP (October 14, 1997)

ATTENDEES

NAME	COMPANY NAME	PHONE NUMBER
Ben Dillon	IPAA	(202) 857-4722
Amy Cebull	Nance Petroleum	(406) 245-6248
David Blackmon	Burlington	(817) 347-2356
Shirley Neff	Shell	(202) 466-1400
Sandra Hendrickson	Elf	(713) 739-2377
Bonn Macy	MMS	(202) 208-3827
Tom White	Walter Oil	(713) 659-1221
Jonathon Hunter	Liskow & Lewis	(504) 556-4131
Stevia Walther	Liskow & Lewis	(504) 556-4158
David Simpson	Total Minatome	(713) 739-3067
Michael Molberg	Total Minatome	(713) 739-3240
Sara Tays	Exxon	(713) 680-7730
Anita Gonzales-Evans	MMS	(202) 208-3821
Linda Allen	Pennzoil	(713) 546-4982
Wayne Pachall	Texaco	(713) 752-7412
Bob Kronebusch	MMS/PMI	(303) 275-7113
Mary Stonecipher	Amoco	(918) 581-4354
John Clark	Conoco	(405) 767-5044
John Haley	Conoco	(281) 293-1683
Ken Wells	Texaco	(504) 595-1213
Don Lynch	Texaco	(504) 595-1331
Ronnie Martin	Texaco	(713) 752-7793
Bob Steubing	Hall-Houston Oil Company	(713) 228-0711
Michael L. Adams	State of Louisiana	(913) 630-0093
Fin Doughty	Calcasieu Refining Company	(713) 652-0018
Bryce Bales	University of Texas Lands	(512) 499-4700
Valdean Severson	State of New Mexico	(505) 827-0952
Tommy Allen	Marathon Oil Company	(419) 421-3551
Robin Perrine	Scurlock Permian	(713) 646-4150
Bob Teeter	Coastal	(713) 877-7019
Mary Ann O'Malley	BP	(216) 586-3664
Robert Leo	Amoco	(805) 880-4386
Georgianna Haines	Marathon	(419) 421-2659
Dow Cambell	Marathon	(419) 421-4121
Fred Hagemeyer	Marathon	(713) 296-2505

Treva Kigar	Marathon	(713) 296-2547
Deniese Palmer-Huggins	NYMEX	(713) 658-9293
David Darouse	State of Louisiana	(972) 783-0029
Jerry Schanke	API	(202) 682-8116
Donald Norman	API	(202) 682-8546
Greg Moredock	Cabot	(281) 589-4600
Terry Kyle	Kerr-McGee	(405) 270-7295
David Lawrence	Scurlock Permian Corp	(713) 646-4387
Becky McGee	Oryx Energy/DPC	(972) 715-3198
Adrian AcEvedo	Oryx Energy	(972) 715-3865
Lawrence Dreyfuss	Scurlock Permian Corp	(713) 646-4143
April Kanah	Anadarko Petroleum Corp	

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HOUSTON

9:00am

Deborah Gibbs Tschudy

- Introductions/Houskeeping/agenda
- Summary of previous workshops.
- Purpose is to receive comments on existing alternatives and new ones.
- Next 3 workshops--Bakersfield, California, and Casper, Wyoming on October 16 and Roswell, New Mexico on October 21.
- Summary of previous workshops will be on Internet.
- At Denver workshop September 30-October 1, 1997, had 8 industry, and 9 State representatives. Deborah Gibbs Tschudy summarized topics covered (Alternatives 1-5) and industry/State responses. Brainstormed various other alternatives.
- At Houston workshop October 7 - 8, 1997, further discussed alternatives. Lots of feedback from marketers. Concern about MMS unwillingness to permit marketing cost deductions. Some State support for fixed costs. Many wanted to use gross proceeds after multiple exchanges. Discussion of gross proceeds use even where calls involved. Proposal to limit aggregation points to simplify differentials. Support for different methods for California, Rocky Mountains, rest-of country. Discussed sales where company acts as refiner in some areas and marketer elsewhere.
- Want to talk about practical valuation methods for Rocky Mountains area

Bob Teeter (Coastal)

- Owns 5 domestic refineries--one in New Jersey, 1 in Corpus Christy--mostly supplied by foreign crude--thus doesn't think should be classified as refiner.
- Doesn't think refiner/non-refiner breakdown should depend on refinery ownership. (If there's a sale, should be treated differently.)

Deborah Gibbs Tschudy

- Comments on Alternative 1 (bid-out program)?

Ben Dillon

- Switching of format may lead to lack of comments. IPAA was willing to discuss significant quantities regarding tendering programs (putting industry volumes "at risk"). Thinks tendering can be 1st benchmark onshore and offshore.

Deborah Gibbs Tschudy

- General State/industry support for tendering as 1st benchmark?

Audience

- General Agreement

Mary Ann O'Malley

- Wanted better description of tendering. BP does outright sales every day--hopes these types of cases can be included in tendering

Ben Dillon

- Philosophically, outright purchases and sales should be considered along with tendering. Need to work on specific criteria. Seems Number 1 issue was comparability. Thought we could reach agreement, though, on like-quality and field or area. Not much movement seen on MMS's part on comparability. Wants "sideboards" so don't move to next benchmarks because auditors don't see "comparability"--single biggest issue he sees.

Deborah Gibbs Tschudy

- Should outright sales be included in tendering program?

Mary Ann O'Malley

- Using tendering as benchmark exclusive of outright sales otherwise seems to be a change in way business actually done. Should consider outright sales under tendering umbrella.

Ben Dillon

- How provide further comments to MMS on comparability?

Deborah Gibbs Tschudy

- Comes down to: how can arm's-length payor know, the next month, whether it paid proper value, and how does MMS know it reflects total value received for production? And how does MMS know the 10 percent reflects value for all production? Need written comments on these.

Dave Darouse

- No official position on tendering

Deborah Gibbs Tschudy

- Move to alternative 2 -- DPC/IPAA benchmarks

Ben Dillon

- Summarized what was agreed on last week:
  - Benchmark 1 Tendering
    - 2 (different than original)--comparables using outright sales & purchases
    - 3 dropped (3rd party sales/purchases)
    - 4 MMS-calculated value with payor certification of arm's-length
    - 5 Netback--if refiner, maybe netback from spot price. Non-refiner, use spot or netback through affiliate. But wants marketing cost deductions

Becky McGee

- DPC had also endorsed benchmarks--position remains that, even beyond comparability issues, there will be complexities we must overcome. Whether under tendering or comparable sales, thinks lease indicator best. Netback only as last resort. Lots of costs are added value that MMS isn't considering as deductions. Some members may have refiners, but don't be quick to characterize or "cubbyhole" situations--look at actual facts. Supports benchmarks as modified in workshops--will give written comments.

Fred Hagemeyer

- Alternative 2--focuses on arm's length notion. Audit criteria should not overwhelm concept of market value at lease. Need to find comfort level on verification. Segmenting classes of trade may be arbitrary (i.e., refiner/non-refiner). Lessors/operators may be willing to verify their arm's-length status.

Deborah Gibbs Tschudy

- Little State support for lease-based benchmark?

Dave Darouse

- Past comments stand.

Bob Teeter

- Generally don't know status of 3rd party sales. But get paid by such entities--often know what other parties get in a field.

Deborah Gibbs Tschudy

- But auditors may say you should have gotten another, higher price in field.

Bob Teeter

- thinks should rely on what you got

Deborah Gibbs Tschudy

- For Rocky Mountains--lease-based indicators. If arm's-length sales are less than 10 percent by volume, how should non-arm's-length production be valued. If not NYMEX, what?

Fred Hagemeyer

- Standard (10 percent) becomes meaningless. The marginal barrel drives price.

Deborah Gibbs Tschudy

- But auditors may say some percent (such as 9 percent) may not be significant quantities.

Fred Hagemeyer

- Argues that the smaller percentage (say 9 percent) may be proper value for 90% of production. May be a de minimus volume that's not applicable, though.

Deborah Gibbs Tschudy

- What if no arm's-length contracts?

Fred Hagemeyer

- then would have to go to some other methodology in field/area. NYMEX difficult in Rocky Mountain area. Also, Platt's Guernsey spot price not good--thinly traded. Perhaps use Canadian prices as option.

Deborah Gibbs Tschudy

- Canadian prices an option?

Fred Hagemeyer

- May not be in Platt's. Relevant because some of this crude may move into Rocky Mountains.

Becky McGee

- Will address this in DPC comments.

Deborah Gibbs Tschudy

- We need help--in Rocky Mountains, what should be benchmark?

John Haley

- Doesn't know whether Canadian crude information available--will address in written comments. Thinks lessee should be allowed to pick among any of available options fitting their circumstances. Should be able to elect before audit and use until conditions change. Situations differ greatly by field, volume, etc. "One size fits all" concept doesn't work.

Dave Darouse

- Regarding Canadian crudes--Platt's figure in average of 3 posted prices--doesn't know how Canadian crude postings work.

David Blackmon

- Any US Crude move to Canada?

Ben Dillon

- IPAA will look into Canadian crude issue further. Netback is last resort.

Michael Molberg

- California is different situation, as in Rocky Mountain area. Can't put in one category. Thinks RIK is solution.

Deborah Gibbs Tschudy

- Alternative 3 (Wyoming benchmark)--arm's length payors report gross proceeds and MMS calculates average for others to use. How to do timely, verify figures are correct, etc?

Becky McGee

- Does MMS think this is workable?

Deborah Gibbs Tschudy

- Doesn't think is workable--audit and verification, timeliness are big problems. What would payors use until we publish information?
- Producer-driven comparables had more appeal
- Little support from States/industry?

Audience-- (NO SUPPORT APPARENT)

Deborah Gibbs Tschudy

- Alternative 4 -- MMS generated option--eliminate 4415 and publish zone/area differentials. Little support at workshops because of winner/losers, although "presumptive" differentials might help..

Michael Molberg

- Different qualities affect differentials, and especially time frames affect differentials--how long good for?

Tom White

- Wouldn't want fixed differentials--based on old data, winners and losers occur, other problems.

Ben Dillon

- thinks Dave Darouse suggestions move toward solving some differential problems.

Deborah Gibbs Tschudy

- Comments on Dave Darouse option?

Patsy Bragg (Did not sign in on sign in sheet)

- Clarify Dave Darouse or previous option?

Deborah Gibbs Tschudy

- Explained MMS location differential and covered problem of allocating to Federal lease.

Dave Darouse

- Explained his streamlined exchange differential proposal. Should eliminate some audit burden. May require submittal of agreements.

Michael Molberg/Mary Ann O'Mally

- So many formats exist on exchange agreements that administrative workload would be overwhelming.
- Doesn't want exchange information released to competitors except on delayed basis--major concern.

Audience:

- Others concurred with this concern

Patsy Bragg

- Presumption that all leases tied to 12 aggregation points.

Dave Darouse

- If production flows to these points, physically or on paper, and exchange generated there, would use this procedure. If exchange at lease, no need for 4415.

Patsy Bragg/Dave Darouse

- Further questions/explanation on Dave Darouse's proposal

Patsy Bragg

- trying to understand how this proposal differs from original MMS proposal

Deborah Gibbs Tschudy

- In New Mexico, may be only 2-3 aggregation points.

Ben Dillon

- MMS "moving in right direction" with Dave Darouse's proposal.

Fred Hagemeyer

- How do you handle different qualities?

Dave Darouse

- Need to keep a quality distinction from the exchange agreement. Need to mirror the actual qualities exchanged--that is, use differentials for oils similar to those now being included.



Michael Molberg

- Actual costs from quality banks would be allowed.

Deborah Gibbs Tschudy

- Support for Dave Darouse's suggestion?

Michael Molberg

- Provisions for exceptions, with only 12 aggregation points?

Fred Hagemeyer

- Doesn't see how Darouse proposal different conceptually, other than fewer aggregation points. Still concern that we aren't capturing market value at lease.

Ben Dillon

- IPAA needs to look at this further--coming from perspective of affiliate sales with cost deductions.

John Clark

- Doesn't necessarily agree with administrative effort required or that method would result in market value.

Michael Molberg

- What is time period for differentials?

Deborah Gibbs Tschudy

- Could do more frequently, do true-ups, or other options.

Bob Steubing

- Perhaps quarterly differentials more timely than annual or look-back basis. True-up would be 2nd best.
- In true-up, it's subjective. Auditor may look at situation differently even when company working in good faith.

Ben Dillon

- Uncomfortable with process. Thinks comments may be taken out of context. IPAA remains opposed to index netback as 1st benchmark.

Becky McGee

- DPC agrees

Dave Darouse

- Stressed that his proposal only for those without actuals. Quarterly submittals may be overly burdensome.

Ben Dillon

- Who would be forced to use NYMEX (and wouldn't have information from aggregation point to marketing centers)?

Deborah Gibbs Tschudy

- those who exercise non-competitive calls.

Dave Darouse

- and those who sell non arms length before reaching marketing center

Tom White

- Thinks would be de minimus numbers of affected parties.

Ben Dillon

- thinks it might be a waste of MMS time to collect such information.

Audience Participant

- Are we talking about just where tendering or 3rd-party sales not applicable?

Deborah Gibbs Tschudy

- talking about somewhere in benchmark system, but not sure where yet?
- Can we determine how many companies wouldn't have the differential information?

Ben Dillon

- IPAA will look at this.

Deborah Gibbs Tschudy

- Presumption that anyone with affiliate has sale to, or exchange at, marketing center, thus has data on differentials to marketing center. Concern is only for those then forced to NYMEX. Thus deal with them on exception basis? Maybe MMS doesn't need to publish aggregation point-market center rates.

Ben Dillon/Becky McGee

- Will survey membership

David Simpson

- May get different answer depending on where NYMEX method falls in benchmarks.

Ben Dillon

- Affiliate may not always go to marketing center.

Becky McGee

- DPC will file comments but not sure can comment on differential question by October 22. Must DPC get comments on this issue by October 22?

Deborah Gibbs Tschudy

- No decision yet on extending comment period.

Ben Dillon

- Should be able to accept comments/feedback technically, after October 22.

Deborah Gibbs Tschudy

- Agrees. Worth spending time on.

(BREAK @ 10:45AM)

Deborah Gibbs Tschudy

- Alternative 5--use spot prices rather than NYMEX. Some support in previous workshops. General preference?

Tom White

- Might be preference for spot over NYMEX. Still sees timing problem--today's NYMEX with today's production is apples/oranges. Same problem with spot prices--they are for next month's delivery.
- Use contract NYMEX as solution. Current month contract price can be less than forward month's contract, although this isn't normal trading pattern ("Contango" market. Normally doesn't pay to store oil) "If force NYMEX down our throat, "forces Companies to basis others don't use. Normal "backwardation" price--current higher than future price. Market hasn't been in normal range this whole year.

Deborah Gibbs Tschudy

- What do you mean by "contract" NYMEX?

Tom White

- For November production, use November contract price developed late September through late October.

Michael Molberg

- Would even out eventually

Deborah Gibbs Tschudy

- Audience favor contract month basis for NYMEX?

Audience

-- Yes

Tom White

-- Further explained Platt's NYMEX data

Deborah Gibbs Tschudy

-- Hearing support for spot prices vs. NYMEX and using contract, vs. forward month?

Scurlock Permian Rep

-- Have to align delivery month with contract prices.

Dave Darouse

-- Concern with timing problem and support for use of heavily-traded spot markets.  
Supports use of gross proceeds where true arm's-length sales occur.

Deborah Gibbs Tschudy

-- Other alternatives suggested?

Ben Dillon

-- Can MMS help me understand proposal concerning calls--particularly exercising noncompetitive calls?

Amy Siebel (Did not sign in)

-- If subject to noncompetitive call, MMS says you would have to demonstrate you tried to get better price. How do I, as arm's length seller at lease, show that price I got is the best arm's length price I can get? May also buy a property that has an old call from previous transactions that has never been exercised and is really nonapplicable. Doesn't think we will find many cases where someone purposely didn't get best price available.

Ben Dillon

-- Are there other ways to address call situations?

Dave Darouse

-- Comments very similar to proposed rule--calls may be subject to low price.

Amy Siebel

-- thinks truly noncompetitive calls apply only to very small percent of cases. Even where calls exist, are usually competitive. Old calls from previously-traded properties may rarely if ever be exercised, but how to prove this to MMS?  
-- Is MMS's main concern that it would receive a below-market price? If so, point rule at that circumstance.

Bob Steubing

-- But wouldn't this be just as big an administrative burden?

Michael Molberg

-- Would MMS accept a certification of competitive price?

Amy Siebel

-- If I get only 1 bid, is that representative of market price?

Tom White

-- For Amy: addressing call referencing a specific posted price? (Amy said yes) Historically, there are lots of these and you may have to go to court to fight the call language.

Amy Siebel

-- Doesn't think such situations worth MMS worrying about. Suggests eliminating call language.

David Simpson

-- Thinks there are 2 situations:  
    If negotiation creates call, need to be concerned.  
    If old calls exist, may be no need for concern.

Amy Siebel

-- Perhaps grandfather those situations with existing calls, vs. those newly negotiated where noncompetitive calls clearly exercised.

Ben Dillon

-- Perhaps only apply call language to forward prices and not look at past occurrences

Tom White

-- Circumstances related to oil price have changed, including sales at posted prices.

Deborah Gibbs Tschudy

-- Says she hears need to add call issue to survey of IPAA/DPC/etc.  
-- Only apply noncompetitive call provisions to sales prospectively? Grandfather other cases?

Dave Darouse

-- hasn't changed call position--thinks is material issue in Gulf.

Amy Siebel

- If issue is MMS isn't getting best price possible, might not have gotten anything at all if property hadn't been bought with call provision.

Dave Darouse

- My be able to discuss some call situation alternatives with Louisiana management.

John Clark

- Can't, in future, retroactively review contract terms and say it isn't good anymore. Has to be viewed from perspective of when negotiated.

David Blackmon

- Thinks issue "much ado about nothing."

Tom White

- Has never seen calls exercised at other than market value. Today's calls typically require competitively-priced calls.

Deborah Gibbs Tschudy

- Is there a time beyond which calls could be grandfathered?

(No response)

Deborah Gibbs Tschudy

- Where do we go from here?
- Action items/surveys

Ben Dillon

- Administratively, partially drives need for form 4415. Willing to explore alternatives.

Deborah Gibbs Tschudy

- Other issues/alternatives?

John Daley

- Under current regulations, lessees can petition MMS for alternative valuation method. Will that be in new rule? Thinks that is a needed part of new rule.

Becky McGee

- Agrees

Deborah Gibbs Tschudy

- Multiple exchanges: Except for California, most participants supported use of proceeds after many exchanges. Comments?

Ben Dillon

- wants to make sure this applies to affiliate and non-affiliate exchanges.

Tom White

- Doesn't own any of proprietary pipeline systems. Views role of producing sector to be efficient production operations and not be worried about marketing or transportation. Affiliated marketer responsible for this. Marketer enters exchange agreements--often multiple exchanges--to get to desired location. His company doesn't own any of proprietary pipelines that production flows through. But must deal with the proprietary systems and go through 3 or 4 exchanges to get best value for oil. Purpose is to maximize ultimate value.
- Wants to be compensated for administrative expenses of getting best price.
- Some other companies may have goal of selling at platform. But others think there's more profit in downstream marketing, with attendant risk. Thinks those who sell downstream must be compensated for work on MMS's behalf.

Ben Dillon

- Wanted to get clarification on what happens where multiple exchanges occur. IPAA believes actual costs of marketing should be allowed. Wants MMS to know this isn't a "front" for the majors. Unless there's movement on deduction of these costs, there will continue to be direct opposition to NYMEX/spot netbacks. Encouraged by States' willingness to look at marketing costs.
- RIK remains preferred option. Frustrates IPAA that just because they're involved in detailed discussions in these workshops, they might be viewed as agreeing with general alternative proposed. IPAA wants to resolve issues without litigation. But doesn't think this can happen without MMS change of stance on marketing costs.

Deborah Gibbs Tschudy

- More alternatives to discuss?

Dave Darouse

- Wants to clarify Louisiana's position:
  1. Tendering--viable 1st option
    - Under tendering:
      - volume should equal royalty value and an equivalent equity volume
      - high bid should be only one considered
  2. Under benchmarks, only other option is go to spot prices
  3. Marketing-- Could accept "soft transportation"--rate along lines of what Alberta used--scalable up to 8¢ for small producer/reseller, 5¢ for large producer/reseller.

John Daley

- Clarified Conoco's tendering program regarding sales to highest qualified bidder. Also pointed out that some bids are volume--limited, so highest price not always representative of value.

Ben Dillon

- appreciates Dave Darouse's marketing cost proposal--most movement and willingness to look at other options he's seen.

Deborah Gibbs Tschudy

- Other alternatives/options?

Becky McGee

- From DPC's perspective, workshop forum useful--got perspective from wide variety of people. Thinks other workshops would be useful to further crystallize remaining issues. Thinks RIK needs to be considered as prime alternative and marketing costs further addressed.

Tom White

- What is MMS' ongoing plan/timing?

Deborah Gibbs Tschudy

- Further notice of proposed rulemaking is next--perhaps by  $\approx$  January 1998.

Mary Stonecipher

- Can we have further dialogue during further notice of proposed rulemaking?

Deborah Gibbs Tschudy

- Yes, during comment period can hold workshops/discussions.

Workshop closed at 12:40PM